

Laws Prohibiting Tax Deduction of Bribes

The OECD Council made an important contribution to the fight against bribery in 1996 by recommending that member countries that had not yet disallowed the tax deductibility of bribes to foreign public officials should reexamine such treatment with the intention of denying deductibility. This recommendation was reinforced in the OECD Council's 1997 Revised Recommendation on Combating Bribery in International Business Transactions, which laid the foundation for negotiation of the OECD Antibribery Convention. All thirty-four signatories to the Convention have agreed to implement the OECD Council's recommendation on denying the tax deductibility of bribes.

As part of the monitoring process on the Convention and the OECD Council's recommendation, the OECD gathers information on signatories' laws implementing the recommendation on tax deductibility. Information on current and pending tax legislation regarding the tax deductibility of bribes is available on the OECD website (<http://www.oecd.org/daf/nocorruption/instruments.htm>). Since 1998, the OECD has posted country-by-country descriptions of the treatment of the tax deductibility of bribes in signatory countries and a summary of pending changes to their laws. The information on the website is based entirely on reports that the signatories themselves provide to the OECD secretariat.

The Treasury Department relied heavily on these reports from signatories to prepare the report in Chapter 4 on laws prohibiting the tax deductibility of bribes. Treas-

ury also drew on information obtained from U.S. embassies on this issue. The 2000 report to Congress provides the latest available information on signatories' tax laws that was available from these sources.

We continue to seek more detailed information on the entire body of signatories' tax and bribery laws so that we will have a better understanding of how the disallowance of tax deductibility will be applied in practice. As part of that effort, the Treasury Department is working to ensure that the Committee of Fiscal Affairs, the OECD body responsible for tax issues, takes a more active role in monitoring the progress of countries in implementing the OECD Council's recommendation. In 2000, the Treasury Department made arrangements to provide U.S. technical expertise to the Committee on Fiscal Affairs in order to assist members in their monitoring work. We believe that our information will continue to improve as the OECD's monitoring process creates a more complete record of each signatory's legal, regulatory, and administrative framework for disallowing the tax deductibility of bribes and makes that record publicly available.

Overall Status of Signatories' Laws Regarding the Tax Deductibility of Bribes

Signatories to the Convention have made substantial progress on implementing the OECD Council's recommendation to disallow the tax deductibility of bribes, and further progress is expected in the year ahead. Only

three OECD member countries (Luxembourg, New Zealand, and Switzerland) have reported that they have not yet completed action necessary to disallow these deductions. Luxembourg has drafted legislation to disallow the tax deductibility of bribes, and New Zealand is in the process of doing so. Switzerland's Parliament approved legislation denying the deductibility of bribes in December 1999. The Swiss cantons have until December 2000 to integrate the federal law into their own tax legislation. If they fail to do so, the federal law will become effective. In addition, the French Parliament recently approved a draft amendment that, when the legislation is enacted, will remove "grandfather" provisions from its laws that might have allowed tax deductibility to continue even after the Convention comes into force for France.

Despite important positive steps taken by signatories to the Convention, we remain concerned that tax deductibility is still continuing. France and the Netherlands have changed their tax laws to disallow the tax deductibility of bribes, but these changes become effective for payments to foreign public officials only when each country brings the Convention into force. Even with the Convention in force, deductibility in the Netherlands as well as several other countries that have laws currently in effect (such as Austria, Belgium, and Japan) may continue for one or more of the following reasons. The legal framework may disallow the deductibility of only certain types of bribes or bribes by companies above a certain size. The standard of proof for denying a tax deduction (e.g., the requirement of a conviction for a criminal violation) may make effective administration of such laws difficult. The relevant laws may not be specific enough to deny deductibility of bribes effectively in all circumstances. The United States has noted its concerns about the effectiveness of measures disallowing tax deductibility in diplomatic exchanges with other Convention signatories and at meetings of the OECD Working Group on Bribery and the Committee on Fiscal Affairs.

Because we believe it is vital that the OECD play an active role in critically evaluating the information provided by member countries, we are working within the Committee on Fiscal Affairs to ensure that adequate resources are devoted to ongoing monitoring of the OECD Council's recommendation on tax deductibility. Committee members support our position. Several members are joining the United States in helping the committee prepare a manual that will assist countries in enforcing the nondeductibility rules and will also enable the committee to better perform its monitoring function. With this and other U.S. assistance, we are

confident that the committee will continue to develop more reliable methodologies for monitoring implementation of the OECD Council's recommendation.

The purpose of describing the limitations of country laws in the tax deductibility of bribes is to ensure continued focus on improving the situation. Whatever the nature of the legal or administrative loophole that makes it possible to deduct a bribe to a foreign public official, the practice must be eliminated. Further, it must be recognized that enactment of rules denying deductibility is only the first step. Careful monitoring is needed to ensure that the rules are actually enforced.

Report on Country Laws Relating to the Tax Deductibility of Bribes

Argentina

Tax deductibility of bribes paid to foreign public officials is not allowed.

Australia

On May 31, 2000, Australia enacted a new law (Taxation Laws Amendment (No. 2) 2000) that amends the Australian Income Tax Assessment Act of 1997 to explicitly disallow the tax deductibility of losses or payments that are bribes to foreign public officials. The disallowance of such losses and payments became effective on the date of enactment of the new law.

Austria

According to legislation passed in late October 1998, bribes paid to foreign public officials are generally no longer deductible for income tax purposes. The Tax Amendment Law of 1998, published in *Bundesgesetzblatt* (Federal Law Gazette) number I/28 of January 12, 1998, amended Section 20, paragraph 1, subparagraph 5 of the Income Tax Act. Under the new legislation, any cash or in-kind remuneration whose granting or receipt is subject to criminal punishment is not deductible from taxable income. The disallowance applies to bribes that are subject to criminal punishment under the Criminal Code, which was amended in August 1998 to extend criminal liability to bribery of foreign public officials. A deduction may be disallowed before a finding of a criminal violation. However, if no criminal violation is found in a court proceeding, the tax administration may have to allow the tax deduction.

Belgium

A bill aimed at criminalizing bribes to foreign public officials and denying the deductibility of so-called

“secret commissions” paid in order to obtain or maintain public contracts or administrative authorizations was adopted by the Senate on July 9, 1998, and by the House of Representatives on February 4, 1999. It was published in the Official Journal on March 23, 1999, and entered into force on April 3, 1999. However, the new law does not disallow the deductibility of all bribes to foreign public officials.

Other types of commissions paid to foreign public officials will remain deductible if such commissions do not exceed reasonable limits, are necessary to compete against foreign competition, and are recognized as a normal customary practice in the relevant country or business sector (i.e., necessary, usual, and normal in the given sector). A tax equal to at least 20.6 percent of the commission must be paid whether or not the commission is deductible. The taxpayer must present a request and disclose to the tax administration the amount and the purpose of the commissions for the tax administration to decide whether the commission is deductible. If all these conditions are not fulfilled, the deductibility of the commissions is denied, and they are added back to the taxable income of the payer. If the payer is a company, it is liable to a special tax equal to 309 percent of the amount of the bribe.

Brazil

Brazil does not allow tax deductibility of bribes to foreign public officials.

Bulgaria

Bulgarian tax legislation does not allow tax deductibility of bribes to foreign public officials. Bribery is a criminal activity under Bulgaria’s criminal code. The deduction of bribes in the computation of domestic taxes is not permitted. This disallowance, however, is not explicit in Bulgaria’s tax legislation.

Canada

Since 1991, the Income Tax Act has disallowed the deduction as a business expense of payments in connection with a bribe in Canada of a foreign public official or a conspiracy to do so. Specifically, effective for outlays or expenses after July 13, 1990, Section 67.5 of the Income Tax Act states that any payment that would be an offense identified in several provisions of the criminal code (including bribes and conspiracy to pay bribes to foreign public officials, or persons or companies connected to foreign public officials) is not deductible for income tax purposes. This provision also waives the normal statute of limitations so that an amount may be dis-

allowed any time it is identified no matter how long after it has been paid.

Chile

Chilean tax legislation does not contain specific provisions or rules concerning bribes paid to foreign public officials. Because bribe payments are not considered to be compulsory payments, they are not deductible.

Czech Republic

Czech taxation law and regulations do not allow deductions of bribes paid to foreign public officials. Deductibility is not possible even in cases where the bribe could be treated as a gift. Gifts are deductible only in exceptional cases under two specific conditions. The gift must be made for one of the following specific purposes: science, education, culture, fire protection, or some other social, charitable, or humanitarian purposes. The gift must not be above a strictly determined percentage of the tax basis. Only if both conditions are fulfilled can the gift be treated as deductible for tax purposes. Although Czech law has never permitted the deduction of bribes, this prohibition has never been made explicit in legislation. The Czech Republic has indicated, however, that it intends to amend its tax law with an explicit statement that bribes cannot be deducted. Such legislation is expected to enter into force on January 1, 2001.

Denmark

The Danish Parliament adopted the bill proposed by the government to deny the deductibility of bribes to foreign public officials. The legislation came into force on January 1, 1998.

Finland

Finland does not have statutory tax rules concerning bribes to foreign public officials. Similar payments to domestic public officials are nondeductible on the basis of case law and the practice of the tax administration. It is expected that this case law would also apply to disallow deductions for bribes paid to foreign public officials. On this basis, the tax administration in practice currently denies deductions for bribes to foreign public officials.

France

The French Parliament passed legislation denying the tax deductibility of bribes to foreign public officials on December 29, 1997, as part of the Corrective Finance Bill for 1997. The law does not allow the deduction of amounts paid or advantages granted directly or through intermediaries to foreign public officials within the mean-

ing of Article 1.4 of the Convention. As originally enacted, the legislation was “grandfathered,” in that it did not disallow deductions for bribes tied to pre-existing contracts. Responding to criticism by other OECD members, including the United States, the French Parliament voted in February 2000 to remove the grandfather provision in the tax legislation. This amendment, which is included in the draft implementing legislation on the Convention, will take effect when the legislation is passed and the Convention comes into force for France (i.e., sixty days after France deposits an instrument of ratification with the OECD).

Germany

Under previous German tax law, deductions or bribes were disallowed only if either the briber or the recipient had been subject to criminal penalties or criminal proceedings which were discontinued on the basis of a discretionary decision by the prosecution. Legislation adopted on March 24, 1999, eliminated these conditions and denied the tax deductibility of bribes. The revised legislation is paragraph 4, Section 5, sentence 1, number 10 of the *Einkommensteuergesetz* in the *Steuerentlastungsgesetz* of March 24, 1999, as published in the *Bundesgesetzblatt* dated March 31, 1999 (BGBl I S. 402).

Greece

Greece does not allow the deductibility of bribes to foreign public officials.

Hungary

Hungary does not allow the deductibility of bribes to foreign public officials, since only expenses covered in the tax laws are deductible, and the tax laws do not include a specific reference to bribes.

Iceland

Since June 1998, Iceland has not allowed the deductibility of bribes to foreign as well as domestic public officials and officials of international organizations on the basis of law (Section 52 of the Act No. 75/1981 on Tax on Income and Capital as amended by Act No. 95/1998).

Ireland

It is the view of the Irish Revenue Commissioners, on the basis of legal advice received, that bribes paid to foreign public officials are not deductible in principle. These authorities doubt that the conditions for deductibility could ever be met in practice in Ireland. Therefore, Ireland has not considered it necessary to introduce specific legislation to deny a deduction.

Italy

Italy does not allow deductions for bribes paid to foreign public officials. Legislation enacted in 1994 made gains from illicit sources taxable. The nondeductibility of bribes was unaffected by this 1994 legislation.

Japan

Bribes to domestic public officials as well as foreign public officials are treated as “entertainment expenses” under Japanese law. Such expenses are generally not deductible. However, small companies (with capital not exceeding approximately \$500,000) can get a deduction for entertainment expenses. If a bribe is not recorded as an entertainment expense, a penalty tax is imposed.

Korea

Korea does not allow deductions for bribes paid to foreign public officials since they are not considered to be business-related expenses.

Luxembourg

The Minister of Justice and Budget has prepared draft legislation that would criminalize bribes to foreign public officials as well as deny their tax deductibility. At present, Luxembourg allows deductions for bribes paid to foreign public officials as any business expense.

Mexico

Mexico does not allow the deductibility of bribes to foreign public officials since they would not meet the general requirements to qualify as deductible expenses. Such expenses must be strictly essential for the purposes of the taxpayer’s activities and must be formally documented. Considering that bribes are treated as illicit activities, such payments cannot meet the requirements set forth in the Mexican Commerce Code. Therefore, the payment of a bribe is not a business activity and is not a deductible item.

The Netherlands

A law that entered into force as of January 1, 1997, denies the deductibility of expenses in connection with illicit activities if a criminal court has ruled that a criminal offense has been committed. This law will apply to bribes of foreign public officials only when Dutch criminal law is amended to ensure that bribery of foreign public officials is a criminal offense.

Until the criminal law incorporating the provisions of the Convention into Dutch law is brought into effect, bribes of foreign government officials will remain deductible unless certain conditions are met. Although there is no jurisprudence on the question, the Netherlands has

indicated that, according to well-established opinion, bribery of a foreign public official committed outside the territorial jurisdiction of the Netherlands constitutes, if certain conditions are met, the criminal offense of falsification of documents or fraud or imposture.

Under the 1997 law, an income tax deduction is denied for costs connected with a criminal offense for which the taxpayer has been irrevocably convicted by a Dutch criminal judge or has met the conditions of a settlement in lieu of conviction. The period between the deduction of costs connected with a criminal offense on the one hand and the conviction for a criminal offense or a settlement in lieu of conviction on the other hand normally takes several years. The law provides that these deductions will be disallowed and added back to income only if the bribe payment took place within the five years preceding the year of the conviction or of meeting the conditions of the settlement. The bribe payment is added back to income in the year in which the conviction becomes irrevocable or the year in which the conditions of the settlement are met.

New Zealand

Legislation is being prepared to disallow deductions for bribery. At present, deductions are allowed for bribes paid to foreign officials, provided the recipient is identified.

Norway

Under Section 44, paragraph 1, litra a, subparagraph 5 of the Norwegian Tax Law, which was passed on December 10, 1996, Norway does not allow deductions for bribes paid to foreign private persons or public officials.

Poland

Poland does not allow the deductibility of bribes to foreign public officials. According to Polish law, bribery is illegal and an offense for both the briber and the recipient of the bribe, and both are punishable. The provisions of the Corporate Tax Act and Personal Income Tax Act are not applicable to illegal activities. Therefore, gains and expenses connected with the offense of bribery cannot be taken into account by the tax authorities. As a result, the taxpayer is not allowed to deduct them from his income expenses concerning bribes to foreign officials.

Portugal

Portugal does not allow the deductibility of bribes to foreign public officials. On December 20, 1997, Parliament adopted new legislation, effective January 1, 1998, to disallow any deduction referring to illegal payments, such as bribes, to foreign public officials.

Slovak Republic

The Slovak Republic does not allow deductions of bribes to foreign public officials or private persons. Bribes are not considered business-related expenses. Recipients of bribes are liable to criminal prosecution. Expenses related to any bribes are not deductible for taxation purposes.

Spain

Spain does not allow deductions for bribes paid to foreign public officials.

Sweden

A bill explicitly denying the deductibility of bribes and other illicit payments to foreign public officials was adopted by the Swedish Parliament on March 25, 1999, and became effective on July 1, 1999.

Switzerland

A draft bill on the denial of tax deductibility of bribes to foreign public officials was submitted in spring 1998 to the cantons and other interested parties for consultation. (Matters of direct taxation are mostly within the competence of the cantons.) The bill was then submitted to the national parliament and passed in December 1999. The legislation is an outline law, and the cantonal parliaments are to integrate its provisions into cantonal tax law by December 2000. Should they fail to do so, the provisions of the federal law on direct taxes become directly applicable at the canton level.

Until such legislation becomes effective, under longstanding administrative practice in Switzerland, bribe and commission payments to non-Swiss recipients are considered business expenses, provided that their effective payment and their relationship to the business of the corporate taxpayer is proven.

Turkey

Turkey does not allow deductions for bribes paid to foreign public officials because there is no explicit rule allowing the deductibility of bribes. Although a possible loophole could allow Turkish corporations operating overseas to deduct bribes in certain circumstances, legislation to implement the Convention, which is currently being reviewed, would eliminate this loophole.

United Kingdom

Under Section 577A of the Income and Corporations Tax Act 1988, enacted under the U.K. Finance Act of 1993, the U.K. does not allow deductions for any bribe if that bribe is a criminal offense, contrary to the Preven-

tion of Corruption Acts. The U.K. has declared that the Prevention of Corruption Acts apply to bribes to foreign public officials. If any part of the offense is committed in the U.K.—for example the offer, agreement to pay, the soliciting, the acceptance, or the payment itself—it would violate the Prevention of Corruption Acts and would then not qualify for tax relief. In addition, U.K. tax laws also deny relief for all gifts and hospitality given, whether or not for corrupt purposes.

United States

The United States does not allow deductions for bribes paid to foreign government officials if that bribe is a criminal offense. Both before and after the United States criminalized bribery of foreign government officials, it denied tax deductions for such payments. Before the enactment of the Foreign Corrupt Practices Act of 1977, tax deductions were disallowed for payments that were made to an official or employee of a foreign government and that were either unlawful under U.S. law or would be unlawful if U.S. laws were applicable to such official or employee. The denial of the tax deduction did not depend on a conviction in a criminal bribery case.

After the United States criminalized bribery of foreign government officials, U.S. tax laws were changed to disallow tax deductions for payments that are unlawful under the Foreign Corrupt Practices Act of 1977 (FCPA). With respect to U.S. tax provisions for Controlled Foreign Corporations, any payment of a bribe by a foreign subsidiary is treated as taxable income to the U.S. parent. Also, to the extent relevant for U.S. tax purposes, bribes of foreign officials are not permitted to reduce a foreign corporation's earnings and profits. U.S. denial of tax deductibility or reduction of earnings and profits does not depend on whether the person making the payment has been convicted of a criminal offense. On tax deductibility, the Treasury Department has the burden of proving by clear and convincing evidence that a payment is unlawful under the FCPA.